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# Report of Working Group V (Insolvency Law) on the work of its twenty-seventh session (Vienna, 9-13 December 2002)

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# I. Introduction: Summary of the previous deliberations of the Working Group

1. The Commission, at its thirty-second session (1999), had before it a proposal by Australia (A/CN.9/462/Add.1) on possible future work in the area of insolvency law. That proposal had recommended that, in view of its universal membership, its previous successful work on cross-border insolvency and its established working relations with international organizations that have expertise and interest in the law of insolvency, the Commission was an appropriate forum for the discussion of insolvency law issues. The proposal urged that the Commission consider entrusting a working group with the development of a model law on corporate insolvency to foster and encourage the adoption of effective national corporate insolvency regimes.

2. Recognition was expressed in the Commission for the importance to all countries of strong insolvency regimes. The view was expressed that the type of insolvency regime that a country had adopted had become a "front-line" factor in international credit ratings. Concern was expressed, however, about the difficulties associated with work on an international level on insolvency legislation, which involved sensitive and potentially diverging socio-political choices. In view of those difficulties, the fear was expressed that the work might not be brought to a successful conclusion. It was said that a universally acceptable model law was in all likelihood not feasible and that any work needed to take a flexible approach that would leave options and policy choices open to States. While the Commission heard expressions of support for such flexibility, it was generally agreed that the Commission could not take a final decision on committing itself to establishing a working group to develop model legislation or another text without further study of the work already being undertaken by other organizations and consideration of the relevant issues.

3. To facilitate that further study, the Commission decided to convene an exploratory session of a working group to prepare a feasibility proposal for consideration by the Commission at its thirty-third session. That session of the Working Group was held in Vienna from 6 to 17 December 1999.

4. At its thirty-third session in 2000 the Commission noted the recommendation that the Working Group had made in its report (A/CN.9/469, para. 140) and gave the Group the mandate to prepare a comprehensive statement of key objectives and core features for a strong insolvency, debtor-creditor regime, including consideration of out-of-court restructuring, and a legislative guide containing flexible approaches to the implementation of such objectives and features, including a discussion of the alternative approaches possible and the perceived benefits and detriments of such approaches.[1]

5. It was agreed that in carrying out its task the Working Group should be mindful of the work under way or already completed by other organizations, including the World Bank, the International Monetary Fund (IMF), the Asian Development Bank (ADB), INSOL International (INSOL) (an international federation of insolvency professionals) and Committee J of the Section on Business Law of the International Bar Association (IBA). In order to obtain the views and benefit from the expertise of those organizations, the Secretariat, in cooperation with INSOL and the IBA organized the UNCITRAL/INSOL/IBA Global Insolvency Colloquium in Vienna, from 4-6 December 2000.

6. At its thirty-fourth session in 2001, the Commission had before it the report of the Colloquium (A/CN.9/495).

7. The Commission took note of the report with satisfaction and commended the work accomplished so far, in particular the holding of the Global Insolvency Colloquium and the efforts of coordination with the work carried out by other international organizations in the area of insolvency law. The Commission discussed the recommendations of the Colloquium, in particular with respect to the form that the future work might take and interpretation of the mandate given to the Working Group by the Commission at its thirty-third session. The Commission confirmed that the mandate should be widely interpreted to ensure an appropriately flexible work product, which should take the form of a legislative guide. In order to avoid the legislative guide being too general or too abstract to provide the required guidance, the Commission suggested that the Working Group should bear in mind the need to be as specific as possible in developing its work. To that end, model legislative provisions, even if only addressing some of the issues to be included in the guide, should be included as far as possible.[2]

8. The twenty-fourth session of Working Group V (Insolvency Law) (New York, 23 July to 3 August 2001) commenced consideration of this work with the first draft of the legislative guide on insolvency law. The report of that meeting is contained in document A/CN.9/504. Work continued at the twenty-fifth (Vienna, 3-14 December 2001) and twenty-sixth (New York, 13-17 May 2002) sessions of the Working Group. The reports of those meetings are contained in documents A/CN.9/507 and A/CN.9/511 respectively.

9. At its thirty-fifth session in 2002, the Commission had before it the reports of the twenty-fourth, twenty-fifth and twenty-sixth sessions of the Working Group. The Commission noted that, at its twenty-sixth session, the Working Group had discussed the likely timing for the completion of its work and had considered that it would be in a better position to make a recommendation to the Commission after its twenty-seventh session (Vienna, 9-13 December 2002) when it would have the opportunity to review a further draft of the legislative guide. The Commission requested the Working Group to continue the preparation of the legislative guide and to consider its position with respect to completion of its work at its twenty-seventh session.[3]

## II. Organization of the session

10. Working Group V (Insolvency Law), which was composed of all States members of the Commission, held its twenty-seventh session in Vienna, from 9-13 December 2002. The session was attended by representatives of the following States members of the Working Group: Argentina, Austria, Brazil, Cameroon, Canada, China, Colombia, France, Germany, India, Iran (Islamic Republic of), Italy, Japan, Kenya, Lithuania, Mexico, Romania, Russian Federation, Rwanda, Singapore, Spain, Sudan, Sweden, Thailand, United Kingdom of Great Britain and Northern Ireland and United States of America.

11. The session was attended by observers from the following States: Algeria, Australia, Bulgaria, Indonesia, Ireland, Jordan, Lebanon, Nigeria, Philippines, Poland, Republic of Korea, Slovakia, Switzerland, Syrian Arab Republic, Turkey, Ukraine and Venezuela.

12. The session was also attended by observers from the following international organizations: (a) organizations of the United Nations system: International Monetary Fund (IMF), the World Bank; (b) intergovernmental organizations: Asian-African Legal Consultative Organisation (AALCO), Common Market for Eastern and Southern Africa (COMESA), Hague Conference on Private International Law; (c) non-governmental organizations invited by the Commission: American Bar Association (ABA), American Bar Foundation (ABF), Center of Legal Competence (CLC), Groupe de Réflexion sur L'Insolvabilité et sa Prévention (GRIP 21), International Federation of Insolvency Professionals (INSOL), International Bar Association, Committee J (IBA) and International Insolvency Institute (III).

13. The Working Group elected the following officers:

*Chairman*: Mr. Wisit WISITSORA-AT (Thailand)

*Rapporteur*: Mr. Luis Humberto USTARIZ GONZÁLEZ (Colombia)

14. The Working Group had before it a Note by the Secretariat: Draft legislative guide on insolvency law (A/CN.9/WG.V/WP.63 and Add.3-15). Those documents, which set forth the text of the commentary of the Guide together with recommendations, had been revised in the light of the discussion of the Working Group at its twenty-fifth and twenty-sixth sessions.

15. The following background materials were also made available: Possible future work on insolvency law: Note by the Secretariat A/CN.9/WG.V/WP.50; Reports of the Secretary-General A/CN.9/WG.V/WP.54, A/CN.9/WG.V/WP.54/Add.1-2; A/CN.9/WG.V/WP.55; A/CN.9/WG.V/WP.57; A/CN.9/WG.V/WP.58; A/CN.9/WG.V/WP.59; A/CN.9/WG.V/WP.61, A/CN.9/WG.V/WP.61/Add.1-2; Report on the UNCITRAL/INSOL/IBA Global Insolvency Colloquium (2000) A/CN.9/495; Report of UNCITRAL on the work of its thirty-fourth session (2001) A/56/17 and thirty-fifth session (2002) A/57/17; Report of Working Group V (Insolvency Law) on the work of its twenty-second session (1999) A/CN.9/469; twenty-fourth session (July/August 2001) A/CN.9/504; twenty-fifth session (December 2001) A/CN.9/507 and twenty-sixth session (May 2002) A/CN.9/511.

16. The Working Group adopted the following agenda:

1. Scheduling of meetings.
2. Election of officers.
3. Adoption of the agenda.
4. Preparation of a legislative guide on insolvency law.
5. Other business.
6. Adoption of the report.

## III. Summary of deliberations and decisions

17. The Working Group reviewed the draft legislative guide on insolvency law commencing with document A/CN.9/WG.V/WP.63/Add.3 and continuing through to A/CN.9/WG.V/WP.63/Add.9, recommendation (76). The deliberations and decisions of the Working Group with respect to the various addenda are set forth below. The

Working Group noted that there might be insufficient time to prepare revisions of the material considered at the current session for further consideration by the Working Group at its twenty-eighth session in New York (24-28 February 2003). In response to the Commission's request to consider its position with respect to completion of the legislative guide, the Working Group stressed the need to finalize the guide as soon as possible and recommended that while the draft Guide may not be ready for final adoption by the Commission in 2003, nevertheless a draft should be presented to the Commission in 2003 for preliminary consideration and assessment of the policies on which the legislative guide is based. Such an approach would facilitate the use of the legislative guide as a reference tool before final adoption in 2004 and would allow those countries that have not participated in the Working Group an opportunity to consider the development of the guide. It was noted that the Working Group might require further sessions in the second half of 2003 and possibly even the first half of 2004 to refine the text for final adoption.

# IV. Preparation of a draft legislative guide on insolvency law

## 1. Part Two. Chapter II. Application and commencement

### A. Eligibility and jurisdiction (A/CN.9/WG.V/WP.63/Add.3)

**Paragraphs 1 and 2—eligibility: debtors to be covered by an insolvency law**

18. There was general support for retaining the substance of paragraphs 1 and 2 as drafted.

**Paragraphs 3 and 4—debtors: individuals engaged in commercial activities**

19. It was suggested that because the insolvency of natural persons required different social and policy considerations to those of commercial entities, the discussion in the commentary should either be deleted, or else moved to a separate section and the different considerations discussed more fully. After discussion, general support, however, was expressed in favour of retaining the material on individuals involved in commercial activity and of the applicability of the insolvency law to those individuals as drafted. It was observed that in many countries commerce was conducted by individuals and to omit them would significantly affect the operation, and effectiveness, of the insolvency law.

**Paragraphs 5 and 6—state-owned enterprises**

20. Some concern was expressed about government organizations, municipalities and other similar entities and whether they were, or should be, covered by the Guide. There was general agreement that the Guide should apply to only commercial enterprises, which would not include government or similar entities except to the extent that they fell within the definition of a state-owned enterprise and conducted commercial activities. To clarify the current text, the Secretariat was requested to add words to the effect that it was not intended that the Guide should apply to states, sub-national governments, municipalities and other similar types of entities.

21. The substance of paragraph 6 was found to be acceptable.

**Paragraphs 7 to 9—jurisdiction: centre of main interests**

22. Support was expressed in favour of a suggestion that the paragraphs should be amended to conform with the UNCITRAL Model Law on Cross-Border Insolvency, in particular with Article 28 and the commencement of non-main insolvency proceedings on the basis of presence of assets.

23. A proposal was made that the Guide should focus only on a debtor's registered office and not establish a presumption as to centre of main interests. After discussion, however, there was general agreement that the presumption should be maintained, in particular to address situations where the debtor's centre of main interests did not coincide with its registered office, a situation commonly encountered in practice.

24. With regard to footnote 1 to paragraph 9 of the Guide, there was general agreement in the Working Group that the Model Law and Guide to Enactment should be included as an additional chapter of the Guide. It was acknowledged that addressing cross-border issues was an essential part of a modern insolvency regime and inclusion of that material would assist readers of the Guide. The need to ensure conformity between the Guide and the Model Law was noted, and that some minor changes to the Guide might be required to update certain references.

**Paragraphs 10 to 13—establishment and presence of assets**

25. The Working Group found the substance of the paragraphs to be acceptable.

**Recommendations**

26. It was suggested that the bracketed word "general" in clauses (a) and (b) of the purpose clause might be deleted as unnecessary. However, there was broad support for retaining the term to prevent ambiguity, especially where States had special insolvency regimes (distinct from the general insolvency law) for certain types of enterprises. It was noted that if the term was to be retained, it should be used consistently throughout the Guide.

27. A suggestion was made that it might assist interpretation if the term "courts" was qualified in clause (d) of the purposes section. It was also suggested that clause (d) be deleted on the basis that the issue of judicial delegation should be determined by the law of each country. In response, it was suggested that there was a need to specify where insolvency proceedings could be conducted to facilitate application for commencement. After discussion, retention of clause (d) was widely supported. It was suggested that the Guide might go further and indicate the types of court that could open a proceeding, in terms of both locality and subject matter. That suggestion received some support.

28. A question was raised as to whether not-for-profit organizations which conducted commercial activities, such as hospitals, would be included within the meaning of "commercial". To clarify that issue, it was suggested that the words "whether or not for profit" could be added to modify the word "commercial" in recommendation (11). It was agreed that the substance of recommendation (12) was acceptable as drafted.

29. It was suggested that the "presence of assets" test should be included in recommendation (13). It was pointed out, however, that the recommendation

adopted a flexible approach, suggesting only minimum and non-exclusive grounds, as agreed by the Working Group at its twenty-sixth session. It was noted that an express reference to the Model Law and the Guide to Enactment could be included to pick up the material on presence of assets as a basis for commencement of insolvency proceedings.

30. It was suggested that the words, "of operations", might be deleted from recommendation (15) to ensure clarity. However, it was noted that the language was based on the Model Law on Cross Border Insolvency and therefore should be retained as drafted.

31. It was also suggested that recommendation (16) might be amended to read, "The insolvency law should clearly state which type of court has jurisdiction over insolvency proceedings and which particular court over matters arising in the conduct of an insolvency proceeding". That suggestion received some support. A further suggestion was that the reference in the recommendation to the "insolvency law" might be omitted, as the jurisdictional rules need not necessarily be contained in the insolvency law.

## B. Application and commencement criteria (A/CN.9/WG.V/WP.63/Add.4)

### Paragraphs 14 to 16—introduction

32. The Working Group agreed that the substance of the paragraphs was acceptable.

### Paragraphs 17 to 22—application criteria

33. Some concern was expressed with regard to the treatment of the liquidity test and the balance sheet test as alternatives (an approach reflected in a number of paragraphs) which could be chosen by a legislator. It was suggested that the Guide should make it clear that both tests could be included in an insolvency law and insolvency proceedings could be commenced where the debtor could satisfy either one of those tests. With regard to the balance sheet test, it was observed that that standard might be misleading as it focused upon what was essentially an accounting question of how the assets would be valued and may raise issues of whether the balance sheet was reliable. It was proposed that the Guide should focus instead on whether the debtor's assets (however valued) were sufficient to satisfy its liabilities, which might be more appropriately called an assets test. It was observed that the ideas reflected in paragraphs 17 to 21 were acceptable, but that some reordering and redrafting might be needed to make the commentary clearer and to reflect the Working Group's discussion on the balance sheet test. It was also suggested that the Guide could usefully include some indicators of general cessation of payments such as failure to pay rent, salaries, employee benefits and other essential business costs.

### Paragraph 23—liquidation: parties who may apply

34. It was observed that some insolvency laws provided for commencement of insolvency proceedings by a court on its own motion, and that that possibility should be included in the Guide. In response, it was pointed out that a clear distinction should be made between a court applying for commencement of proceedings and making a decision to commence on the application of another party.

To allow the court to undertake both actions would create a potential conflict or bias and be contrary to the clear, predictable and transparent insolvency regime that the Guide was recommending. The Working Group agreed that the court should not be able to commence proceedings on its own motion, only on the application of another party.

**Paragraphs 24 to 26—liquidation: debtor application**

35. A concern was expressed that the second part of the first sentence of paragraph 24 suggested that the court could commence proceedings even where the debtor did not satisfy any test of insolvency. In response it was observed that while in practice a debtor application might be treated more flexibly in terms of strict requirements, it was not to be suggested that proceedings could be commenced on a debtor application where creditors objected to such commencement or where to do so would amount to an abuse of the process. It was suggested that a distinction had to be drawn between accepting what the debtor said about its financial condition where no objections were raised, for example, by creditors and not questioning a debtor as to its financial circumstances where there was some doubt about its financial situation or where creditors raised objections to the commencement of proceedings. It was observed that some insolvency laws did provide that a declaration of insolvency by the debtor amounted to a presumption of insolvency or was treated as sufficient evidence of insolvency to commence proceedings without further verification. It was questioned whether the latter approach was desirable and whether or not some further proof should be required or could be demanded by creditors. It was noted that that approach was currently under consideration in one country that was reforming its insolvency law. As a matter of drafting it was suggested that the second sentence of paragraph 24 should end after the words "unable to pay its debts" to remove any uncertainty. The Working Group agreed that those issues required some further clarification and discussion in the Guide.

**Paragraphs 27 to 31—liquidation: creditor application**

36. With respect to the requirement for debts to be undisputed in paragraph 27, the suggestion was made that a debt did not need to be totally undisputed, but rather that a significant portion should be undisputed or free of offset. It was agreed that that issue should be further addressed.

37. Whilst noting that creditors holding unmature debt may have a legitimate interest in insolvency proceedings, it was pointed out that under some insolvency laws debt could not be claimed unless and until it matured. Under other insolvency laws, the failure to pay an instalment on long-term debt might form the basis of a creditor application. It was suggested that those examples should be included in the discussion.

38. The Working Group discussed the question of whether a single creditor could apply for commencement of proceedings and the manner in which the number of creditors required related to the value of their claims. A view was expressed that problems might arise, for example, where a debtor had a number of small creditors which it could pay and a single large creditor which it could not; in that case only the single large creditor should be able to apply for commencement. A suggestion was that a distinction could be drawn between the number of creditors required to bring an application and what was required to be proved—whether the debtor's

inability to pay its debts related to some, all or the majority of its debts. A further view expressed was that a single creditor could apply for commencement where it had followed the procedure in paragraph 27 and served a demand for payment that was not met. After discussion, it was agreed that the Guide adequately addressed the various options with respect to creditor applications and that they were acceptable as drafted.

39. As a matter of drafting, it was suggested that the word "inexpensive" in paragraph 28 should be replaced with "cost-effective". That change was supported.

40. The Working Group agreed that the substance of paragraphs 29 to 31 was acceptable.

**Paragraphs 32 and 33—applications by governmental authority**

41. It was questioned whether paragraph 32 addressed the situation of a government authority as a creditor, and paragraph 33 other situations where the government authority was not a creditor and where the purpose of insolvency proceedings was not to address insolvency but issues such as fraud or other criminal offences. The Working Group agreed with that interpretation and that that distinction needed to be stated more clearly in the text.

**Paragraphs 34 and 35—reorganization: debtor application**

42. An additional factor suggested in support of relaxing commencement criteria for reorganization and proposed for inclusion in paragraph 35 was the need to encourage debtors to apply at an early stage of their financial difficulties, for example, where the payment of mature debts caused financial hardship but not necessarily insolvency. It was noted that that situation might fall within the meaning of future inability to pay in recommendation 18(a).

**Paragraphs 36 to 40—creditor application**

43. It was suggested the section might be improved by redrafting to separate two key ideas: the adoption of a flexible approach to fixing commencement criteria for creditors so as to enable practical difficulties encountered to be overcome, such as the need for creditors to apply for commencement where the debtor would or could not (e.g. because management had left) and the likely discouraging of creditor applications if a creditor proposing reorganization was required to show that sufficient means were available to achieve a successful reorganization.

44. It was also suggested that a clear distinction needed to be made between debtor and creditor applications, which the Guide might better facilitate by introducing the common rules for both and then discussing the two procedures separately.

45. Another suggestion was that the reference to enhancement of the value of creditors' claims in the second sentence of paragraph 36 be amended to refer to enhancement of the value of assets and the increased return to creditors on their claims.

46. It was noted that the opening words of paragraph 40, "for these reasons", did not necessarily have a connection to the preceding paragraph and should be clarified.

**Paragraphs 41 to 43—procedural issues**

47. It was suggested that the title of paragraph 41 should be amended to "Application for commencement" to more accurately reflect the content. A further suggestion was that the paragraph should simply note that the process might be initiated by application to a competent court, without any further discussion of detail. In response, it was noted that since some jurisdictions provided for initiation without court involvement the current draft should be retained, or a new first sentence added to the effect that "The insolvency law should specify how the insolvency process is commenced". It was also observed that other applicable law might affect the manner in which the procedure was initiated.

48. It was generally agreed that the section may need some minor amendment to acknowledge that court involvement may not be necessary for initiation of the process, as discussed in relation to paragraph 41. A suggestion for an addition to the Guide to explain the reasons for requiring a court determination was that it helped to protect against abuse of the procedure by creditors.

49. An observation, applying generally to the paragraphs 42 and 43, was that a clearer distinction should be made between voluntary and involuntary proceedings. Further, it was suggested that since the section currently focused on involuntary proceedings that focus should be expressly stated in the Guide.

50. A suggestion which was supported was that the Guide note the transition in several insolvency laws towards granting the debtor a fundamental right to be heard by the court or body that would determine an application for commencement.

51. It was suggested that the words, "to evade its creditors" be removed from the second sentence of paragraph 43, as other forms of abuse existed which did not need to be detailed in the Guide. It was suggested that the text of the last sentence of paragraph 43 should be amended to stress the need for clear rules on the application of the stay to this interregnum period and include a cross reference to chapter III.

52. Another cross reference suggested was to the discussion in the Guide of the responsibilities of the directors or management of the debtor to apply for insolvency proceedings (paras 229-230, Chapter IV, A/CN.9/WG.V/WP.63/Add.10).

53. Several drafting suggestions were made: to remove the word "composite" from the first sentence of paragraph 38; and to replace the phrase "application for insolvency" in paragraph 41 with a more appropriate reference to relief or commencement.

**Paragraphs 44 and 45—procedural issues: establishing a time limit for making the commencement decision**

54. The substance of the paragraphs was found to be acceptable.

**Paragraph 46—procedural issues: denial of the application to commence**

55. Support was given to the suggestion that the section be redrafted to apply to both voluntary and involuntary proceedings and the title amended to, "Denial of the application to commence or dismissal of proceedings". It was recalled that that issue had been discussed at the Working Group's twenty-sixth session (see document A/CN.9/511, para. 37). The Secretariat was requested to add commentary and

recommendations (see also para. 80 below) to the Guide on the dismissal of proceedings. It was suggested that any revision should cover all possible arrangements under current laws, including those that allowed automatic commencement.

56. A further suggestion was that, while the grounds for denial of the debtor's application should be kept to a minimum and the debtor be given a limited time to remedy any defects in an application, the requirements placed on creditors should be more strictly applied.

57. A number of suggestions were made regarding amendment of the grounds for denial of the application for commencement contained in paragraph 46. The observation was made that, in reviewing the current list, the Working Group should not confuse grounds for denial with incidents of abuse of the subsequent procedure which could be dealt with under dismissal. Support was expressed for retaining in the list, in some form, the ground of obtaining preferential payments by the debtor, as it was noted that it was not uncommon in the case of an involuntary application for pressure to be applied to the debtor for such payment and any form of coercion of payment could be an inappropriate use of insolvency proceedings. An opposing view was that it would be inappropriate for a court to make such a decision because the investigation of such payments was a key function of insolvency proceedings.

58. A suggestion was made that use of the insolvency proceedings as a substitute debt enforcement mechanism should be removed from the list on the basis that although perhaps an inappropriate use of insolvency it should not, in itself, represent a ground for denial of an application. Suggested additions to the grounds for denial were insufficiency of assets (which should be cross-referenced to the discussion of assetless estates in paragraphs 52 and 53 and a note made in paragraph 46 that that ground for denial was not recognized in all States) and involvement in fraud or other criminal activity.

59. A number of drafting suggestions were also made: in the third sentence of paragraph 46 the word "unjustifiably" be added; the phrase, "to obtain" be altered to "obtaining"; and the phrase, "of debts in full" be deleted (the example would read, "where the debtor uses insolvency as a means of prevaricating and *unjustifiably* depriving creditors of prompt payment or *obtaining* relief from onerous obligations, such as labour contracts"); and that the word, "inappropriate" should qualify "substitute" in the fourth example.

**Paragraphs 47-51—procedural issues: notice of commencement**

60. It was suggested that a clear distinction needed to be made in the Guide between notification of application and notification of commencement, as different consequences would result. Paragraph 47 should expressly address notification of commencement.

61. Strong support was expressed in favour of emphasizing in paragraph 49 that the debtor had a fundamental right to be notified (which should be cross-referenced to the discussion of the rights of the debtor in paras. 218-220, Chapter IV, A/CN.9/WG.V/WP.63/Add.10), and it should only be in very exceptional circumstances that notice to the debtor could be dispensed with, such as where the debtor was likely to act to the detriment of the creditors or where the debtor had disappeared. In response it was pointed out that if the debtor was not notified it

could continue to act to the detriment of the estate. It was also observed that the issue of the debtor acting to the detriment of creditors might be better addressed by application of provisional measures. Strong support was expressed for retaining the notice requirement even where the debtor had disappeared. Where the debtor sought to avoid receiving personal notice, requirements for public notification might suffice, or notice could be served at the last known address of the debtor.

62. In voluntary application situations where there was a delay between application and commencement, it was suggested that creditors needed to be notified of the application so as to be able to make an informed decision as whether to continue to provide services to the debtor, with the possibility of incurring further debt during the interim period.

63. A number of options for achieving effective notification were suggested (see para. 74).

64. It was noted that the terms "involuntary" or "creditor" application in the first sentence of paragraph 49 may be confusing since involuntary applications were not necessarily limited to creditor applications and the terminology should be clarified.

65. It was suggested that trade unions and employee representatives might also be added to the list of parties in paragraph 50 to receive notice of commencement.

**Paragraphs 52- 54—procedural issues: assetless estates**

66. Support was expressed for adding the desirability of rehabilitating entrepreneurs and other individuals engaging in commercial activities, and encouraging economic risk-taking by those same parties as further reasons for addressing the administration of assetless debtors. It was also suggested that a reference to revenue should be added to address those debtors that had no assets but did have a regular source of revenue and should not be treated in the context of "assetless" estates.

**Paragraphs 55-56—costs of the insolvency proceeding**

67. The comment was made that the paragraph, as drafted, reflected an awareness of the importance of cost-effectiveness in the design of an insolvency regime without drawing any effective conclusion. It was suggested that a stronger statement to the effect that a high cost regime would discourage commencement and use of insolvency proceedings should be included.

68. The substance of paragraph 56 was found to be acceptable.

**Recommendations**

69. Support was expressed in favour of deleting paragraph (b) of the purpose clause as those words were already included in the purpose clause in chapter II.A. A suggestion was made that paragraph (f) should appear before (e) as a more logical sequence.

70. Some concern was expressed with respect to the commencement criteria in recommendation (18) and a number of additions and amendments suggested. To reflect the Working Group's agreement with respect to the application criteria (see para. 33), the word "alternatively" should be deleted; the conclusions of the

Working Group's discussion on the requirement that the debt be undisputed should be reflected, together with the additional word "whole" added to clarify that a part but not all of the debt could be disputed (the same change was to be made to (19); the word "general" should be added to the reference to cessation of payments to align recommendation (18)(a) and (b) with paragraphs 17 and 18 of the commentary; and recommendation (18)(b) should include the words "or will be" before "unable to pay its debts" to cover prospective insolvency. In response to that last suggestion, the view was expressed that prospective insolvency should only apply to debtor applications and not to creditor applications. The view was also expressed that recommendation (18)(a) should adopt a more flexible approach to encourage debtors to file at an early stage and to encourage reorganization, with a necessary distinction being drawn between the commencement criteria for liquidation and reorganization.

71. While some support was expressed for version 2 of recommendation (19), after discussion the prevailing view was that version 1 should be retained and incorporate footnotes 5 and 6.

72. A suggestion with respect to recommendation (20) was that the choice between paragraphs (a) and (b) should be expressed more clearly.

73. To address commencement by a government authority, which was discussed in the commentary, the words "or a government authority" should be added to recommendation (21) after the word "creditor", with any necessary changes to take account of commencement by a public authority on a public interest rather than insolvency basis. To reflect the Working Group's discussion on the exceptions to provision of notice to the debtor, it was suggested the word "generally" be added to the chapeau after "the insolvency law".

74. Some concern was expressed with regard to recommendations (22) to (24) on notification of commencement of proceedings. One view was that a clear distinction should be made between notification of specific parties and general publication of the fact of commencement. With respect to publication, the view was expressed that publication in a government gazette was generally only a formality and should not be relied upon to provide effective notice, and that the reference to national newspapers should be deleted and replaced with a reference to local newspapers in the location of the debtor's business. As an alternative to specifying the types of publications in which notice might be given, it was suggested that a formulation along the lines of "a publication that was generally likely to come to the notice of interested parties" should be adopted. The possibility of using electronic communications to effect notice to individuals was also suggested for inclusion. To clarify the procedural nature of recommendation (22), it was suggested that the opening words could include a reference to the need to establish a uniform procedure for notification. With respect to the party to provide the notice, it was proposed that the last sentence of recommendation (22) should be changed from "may" to "should". The Secretariat was requested to take those suggestions into account in revising the recommendations.

75. With regard to recommendation (23) it was suggested that the party responsible for preparing the list of creditors to be notified should be specified. The words "[who may be identified from the books and records of the debtor]" were felt

to be unnecessary and possibly limiting, as there could be other known creditors who could not be so identified.

76. Suggestions made to add further requirements to recommendation (24) including providing information relating to verification of claims and any time frame within which that might occur, and to the application of a stay and its effect.

77. Some concerns were expressed with respect to the drafting and content of recommendation (25). It was pointed out that recommendation (25)(b) was too limited as it did not address the situation where the application was made by multiple creditors. Where the debt of one of those creditors was subject to dispute, that should not result in the application being denied. The view was expressed that the criteria mentioned in the recommendation were too narrow and should include, for example, failure to meet time limits, issues related to competency of the parties, and non-payment of procedural expenses. In addition, the words "inter alia" should be added to the chapeau. A further suggestion was that since paragraph (c) should apply to both liquidation and reorganization, the opening words could be deleted. As a matter of drafting, it was suggested that paragraph (a) should be placed at the end of the list.

78. It was observed that dismissal of proceedings (which may be needed, for example, where an application by a debtor functioned as automatic commencement) and costs and sanctions were not addressed in the recommendations. Where an application functioned as automatic commencement (and notice would have been given of commencement) and the proceedings were subsequently dismissed, it was suggested that notice of the dismissal may also be required to protect the debtor's business. Those proposals were supported.

79. A proposal was made that recommendation (26) should distinguish between individual and corporate debtors. Recalling paragraphs 52 to 54 of the commentary, it was suggested that (26) should apply only to those situations where the debtor was not an individual who was entitled to a discharge, since in that case the application should not be denied. It was observed that the first sentence should refer to absence of "unencumbered" assets, not to assets in general.

80. After discussion, the following draft recommendations on dismissal, and costs and sanctions were proposed for future consideration by the Working Group.

***Termination and dismissal of an insolvency proceeding***

**(26A) The insolvency law may provide that the court may terminate or dismiss a proceeding that has been commenced, if the court determines, for example, that:**

**(a) The proceeding constitutes an improper use of the insolvency law;**

**(b) The debtor has failed to comply with the orders of the court or the provisions of the insolvency law;**

**(c) The debtor has failed to cooperate with the insolvency representative; or**

**(d) There has been [unreasonable] delay in the proceedings [that has been prejudicial to creditors].**

[*Note: The above grounds would apply to either a liquidation or reorganization proceeding. Although chapter V.A(14) discusses potential grounds for conversion of a reorganization to a liquidation proceeding, there exists no recommendation on this topic. Additional grounds for conversion might include: continuing to incur losses during the reorganization period; and failure to confirm a plan of reorganization within [a reasonable period] [the statutorily prescribed period] of time. The grounds for dismissal may need to be distinguished from grounds for conversion.*]

**(26B) The insolvency law should provide notice to creditors of a determination to terminate or dismiss an insolvency proceeding.**

[*Note: The same provision may need to be included in respect of conversion from reorganization to liquidation.*]

***Costs and sanctions***

**(26C) The insolvency law should impose a reasonable fee for the privilege of making an application to commence an insolvency proceeding.**

**(26D) The insolvency law may provide that the court should have the power to determine whether an application for commencement constitutes an improper use of the insolvency law. In the event of such a finding, the court may permit assessment of costs or sanctions against the applicant.**

[*Note: The applicant might be a debtor in the case of a voluntary petition or creditors in the case of an involuntary petition.*]

## 2. Chapter III. Treatment of assets on commencement of insolvency proceedings

### A. Assets to be affected (A/CN.9/WG.V/WP.63/Add.5)

81. It was suggested that the words in parentheses at the end of paragraph 57 either should be deleted as they were confusing or amended to refer to the replacement or interruption of the powers of the debtor by the insolvency representative.

**Paragraphs 59 to 65—assets of the insolvency estate**

82. With respect to terminology, it was proposed that the Guide should refer consistently to the "assets and rights" of the debtor that would constitute the estate.

83. It was observed that footnote 1 to paragraph 59 would only apply where the debtor was an individual and that in at least one insolvency law, the debtor would retain the right to sue for personal bodily injury and loss of reputation, but not for any associated loss of earnings.

84. The view was expressed that paragraph 60 should include a clear statement that recognized the need to affect the rights of secured creditors in order to achieve the goal of reorganization. A related suggestion was that paragraph 62 should indicate the need for a clear definition of the rights of secured creditors in order to enable the pricing of credit risk, along the lines of "An insolvency law should set

forth clearly the rights of secured creditors in dealing with their security." That proposal was supported.

85. The substance of paragraph 61 was found to be acceptable.

86. It was observed that paragraph 63 related only to individual debtors and could be moved to paragraph 68 for greater clarity. A further suggestion was that additional discussion, addressing the relevance of non-insolvency law to the treatment of joint assets in insolvency and examples of the jointly owned assets that may be accessed in insolvency, should be added. That suggestion was supported.

87. Concerns were expressed as to whether third-party-owned assets were to be included in the insolvency estate and the circumstances under which they could be used in the insolvency proceedings (whether or not they were a part of the estate). Whilst noting that the issue of use was addressed in chapter III.C, it was agreed that greater clarity was required in paragraph 64.

**Paragraphs 66 to 68—assets excluded from the insolvency estate**

88. The suggestion was made that a further example of assets to be excluded was assets that might be subject, under some laws, to reclamation, such as goods supplied before commencement but not paid for and recoverable by the supplier (subject to identification and other applicable conditions).

89. The substance of paragraph 66 was generally acceptable.

90. The view that paragraph 67 should not be included within the exclusion section but under a separate section was supported. In addition, some support was expressed in favour of the proposal that the paragraph should state clearly the desirability of the estate comprising all assets of the debtor wherever they were located. It was noted in particular that the exclusion of foreign assets could affect the ability to reorganize a debtor.

**Paragraphs 69 and 70—recovered assets**

91. It was generally agreed that paragraph 69 should be aligned with the discussion of avoidance provisions in chapter III.E and the various types of transactions subject to avoidance mentioned. Several additions were proposed to the first sentence: the addition of the word "encumbered" after "improperly"; a reference to transactions that resulted in insolvency, not simply to those occurring at "a time of insolvency"; and a reference to transactions involving gifts to parties other than creditors, for example to a spouse at a time when the debtor was insolvent, or became insolvent as a result of the gift. It was observed that in the cross-border context, jurisdictions that did not provide for the avoidance of certain types of transfers may encounter difficulties with recognition and cooperation.

92. It was agreed that paragraph 70 should be cross-referenced to other sections of the Guide addressing unauthorized transactions.

**Recommendations**

93. With regard to the purpose clause, it was proposed that paragraph (d) should be reinstated in the light of the discussion on secured creditors and third-party-owned assets, with appropriate changes to (d) and to the chapeau to reflect the

substance of the section, i.e. constitution of the estate, not the effect of commencement.

94. The Working Group considered two proposals concerning recommendations (27) and (28). The first was that the words "wherever situated" should be added to (27)(a) at the end of the first phrase and recommendation (28) deleted, and the second that recommendation (28) should be amended to read "... the insolvency law should specify that the insolvency estate would include all assets wherever located." Some support was expressed in favour of both proposals, and the prevailing view was that in the light of the Working Group's decision to incorporate the UNCITRAL Model Law on Cross-Border Insolvency into the Guide, it was appropriate for the Guide to adopt a strong statement in favour of the universal approach. It was suggested that if a country were to adopt a universalist approach, the Guide should flag the need for an insolvency law to adopt clear rules to provide certainty for creditors, and should address the issue of recognition (and include a cross reference to the Model Law on Cross-Border Insolvency). It was also determined that the commentary should recognize that some nations may wish to adopt a different approach.

95. Two changes were proposed to recommendation (29): that the reference to natural persons in the heading be reinstated and that the words "which may include assets acquired after commencement of the insolvency proceedings" be deleted.

## B. Protection and preservation of the insolvency estate (A/CN.9/WG.V/WP.63/Add.6)

96. As a working method, the Working Group discussed and agreed to focus on the recommendations in the Guide, with alterations to be made to the commentary to reflect the relevant deliberations and considerations. The Working Group requested the Secretariat to reflect the issues discussed in the context of the recommendations in the relevant parts of the commentary and to align the texts.

### Recommendations

97. Support was expressed for the specific detail of the second alternative in square brackets in clause (a) of the purpose section. Otherwise, the substance of the section was acceptable.

98. It was suggested, with some support, that the Working Group's earlier deliberations regarding the possibility that the debtor might not need to be notified in exceptional circumstances should inform the drafting of recommendations in this section to minimize the potential for damage.

99. The following changes were suggested regarding the text of the chapeau to recommendation (30): that the phrase, "any interested party" in the second line be replaced with "debtor, creditors or third parties" to reflect the agreement on the purpose clause; that the third line be amended to read, "the assets *and rights* of the debtor"; and that the word, "urgently" be removed from the text in the square brackets and the square brackets be deleted. Those changes were supported.

100. It was suggested the words "as requested" might be added to the end of recommendation (30)(a).

101. Some concern was expressed that the powers to be given to the insolvency representative in recommendation (30)(b) may be too broad for all cases, as it might depend upon whether the insolvency representative was appointed to supervise or control the debtor's business. It was felt that the ability to sell should be more limited to avoid possible abuse by the insolvency representative, such as the sale of all the assets. Support was expressed, however, for the suggestion that the phrase, "in the ordinary course of business" and the phrase "including" (which could be changed to "may include") should adequately address that concern. It was also noted that some regimes required the posting of a fidelity bond by the insolvency representative to protect against any defalcation. It was suggested it should be made clear that the term, "other person" did not refer to the debtor. Some support was expressed in favour of removing the brackets from both sets of text in recommendation (30)(b), although it was pointed out that the second phrase may not be necessary as it was already contained in the chapeau.

102. It was suggested that the cross reference in recommendation (30)(d) should extend to all of recommendation (35) and not be limited to (35)(d).

103. It was suggested that the first sentence of recommendation (31) should refer to the individual or body authorized to carry out the provisional measures rather than to a balancing of the responsibilities of the debtor and the interim insolvency representative. Another suggestion, referring to the second sentence of the recommendation, was that the powers of the debtor to continue to manage its business should be able to be restricted even if no interim insolvency representative was appointed. A number of drafting suggestions to recommendation (31) were also made: in the second sentence, the word "unless" be replaced by "except to the extent"; and, in the same sentence, the word, "powers", be altered to either "powers and rights" or "rights and obligations".

104. It was agreed that the word, "may", in recommendation (32) should be replaced by "should" and that the opening words should be "Where appropriate ...", on the basis that, in conjunction with recommendation (33), it would account for situations where no notice was provided to the debtor. In response, it was suggested that that approach may not be needed as notification of provisional measures could be distinguished from notification of commencement.

105. It was generally agreed that the following words be added to recommendation (33): "where the debtor has not been given prior notice, the court shall order that [within ... days] [upon urgent application] [within a reasonable period of time] [promptly], the debtor may be heard in opposition to all or part of the relief given". Emphasis should be placed on limiting the time period to prevent the entire value of the business disappearing, and a footnote to the recommendation could provide that emphasis. It was suggested that the Guide note that preliminary measures should in any event be subject to periodic review and renewal. A further addition to the recommendation was suggested to provide for sanctions against improper use—"To the extent that the court finds relief was improperly obtained, it should retain the discretion to assess costs and fees". A drafting suggestion regarding recommendation (33) was that "the debtor" be added after "the insolvency representative". It was also suggested that the phrase, "at its own motion", should be replaced with words to the effect that the debtor could always be heard by the court and the decision to modify must be notified. An alternative suggestion was that the phrase be followed by the words, "after proper notice of hearing".

106. It was suggested that the following words be added to the end of recommendation (34): "... or the application to commence proceedings is denied or dismissed". It was agreed that a note might be made in the discussion on competence issues to address whether the composition of the court reviewing such measures would be the same as the court granting the measures.

107. It was noted that recommendation (35)(a) was derived from, but did not mirror Article 23 of the Model Law on Cross-Border Insolvency. To address the issue of preservation of claims, it was agreed that the words of the Model Law and its Guide to Enactment be incorporated in some form in the recommendation. With respect to quantification of claims, it was suggested that the reference should be deleted from recommendation (35)(a) and the commentary could indicate that the court could always entertain relief from the stay on that issue. There was support for the proposition that recommendation (35)(c) should not operate to preclude the termination of a contract if the contract provided for a termination date that happened to fall after commencement of proceedings.

108. It was suggested that a list of exceptions to an automatic stay might be usefully added to the Guide, including, for example, proceedings in which the debtor had personal injury or family law claims. There was agreement that the exception should not extend to situations of mass tort, although claimants might have the right to seek relief from the stay on an individual basis. After discussion, the Working Group agreed the Guide should state that an insolvency law may provide some exceptions to the stay, and if so, those exceptions should be stated clearly.

109. A number of drafting amendments to recommendation (35) were made: that the second line of (35)(a) refer to, "the assets *and rights* of the insolvency estate"; and, that the bracketed words in recommendation (35)(a) be amended to "are considered *urgent and* necessary by the court". It was also suggested that the second part of clause (a) beginning, "except to the extent", may not be necessary. A further suggestion was that the phrase, "including perfection or enforcement of security interests", could be deleted from (35)(a) as the matter was dealt with by recommendation (40), which included a cross reference to recommendation (35).

110. It was suggested that recommendation (36) should indicate some limitations or restrictions to the relief envisaged by the clause.

111. There was general agreement that "may provide" be amended to "should provide" in recommendation (37) and the words "after commencement" be added after the word "court".

112. After discussion, it was agreed that recommendation (38) required a statement of when and for how long provisional measures (including those referred to in recommendation (36)) would be effective. With respect to measures automatically applicable on commencement, it was suggested that it should be made clear in the recommendations that they would be applicable "at the time of making the decision to commence".

113. The substance of recommendation (39) was found to be acceptable.

114. After discussion, the Working Group agreed that the term, "for the duration of that proceeding", in recommendation (40)(a) was inadequate as it conveyed the impression the stay may apply for an open-ended period. The Working Group was

unable to reach final agreement on an alternative phrase, although it was agreed that it should be clear the period was finite. Suggestions made included that the stay would remain in place during the period leading to the formulation or approval of a reorganization plan, or the earliest of the time when (i) the plan became effective or any stipulated period for duration of the measures automatically applicable ceased, (ii) the proceedings were closed or (iii) the court granted relief to the secured creditor from the measures automatically applicable. Some support was expressed in favour of the latter formulation. The Working Group agreed to amend the reference to the number of days in recommendation (30)(b) which might be moved from the clause to a footnote with an accompanying note to the effect that the period was indicative. By way of clarification, it was suggested that the Guide should make it clear that if secured creditors were excluded from the insolvency estate, they would not be covered by the stay under recommendation (40).

115. It was also agreed that the reference to harm in recommendation (40)(b)(ii) be changed to a statement that the secured creditor would not be adequately protected, a concept which should be explained in the commentary.

116. Some concerns were expressed with respect to the scope of recommendation (41)(a). In particular, it was questioned whether it should apply to both liquidation and reorganization. After discussion it was agreed that it should apply in both types of proceedings and appropriate clarification should be made in the text. A number of preliminary suggestions were made as to drafting: the replacement of "on grounds that may include" with "on a determination by the court"; the addition of the words "and the insolvency representative demonstrates that it" before "is not necessary" in recommendation (41)(a) and the deletion of "as a going concern" in (41)(a)(ii).

117. A second concern related to the interpretation of recommendation (41)(a) to (c) and in particular whether paragraphs (a) and (b) were cumulative or exclusive. After discussion, the prevailing view was that to prevent the lifting of the stay it would have to be shown that the asset was of value to the estate, and that it was necessary either for a reorganization or for a sale of the business. To implement that requirement more clearly, it was suggested that paragraph (a) be split into two parts, addressing value and the need to retain the asset separately. Another suggestion was that a more appropriate test could be achieved by linking recommendations (40) and (41) more closely and adopting the test of maximization of value rather than necessity for a sale in prospect. It was observed that the chapeau only used the words "that may include" which did not indicate exclusive requirements and should be sufficiently flexible to accommodate the concerns discussed. It was suggested that part of the difficulty encountered in the discussion might be due to different interpretations of "no value". Since it could mean literally of no value, or it could mean that the secured creditor was undersecured and the value of the claim exceeded the value of the secured asset, that issue should be clarified in the text.

118. With respect to recommendation (41)(b) it was suggested that the reference to "[...] days" should be substituted with a less specific reference to a deadline or time period set by the insolvency law or by the court. It was recalled that a similar change was to be made in respect of recommendation (40)(b).

119. As a matter of drafting, it was suggested that the second reference in (41)(c) to "asset" should be replaced by "secured creditor". It was also queried whether the

use of "secured asset" was appropriate and it was agreed that that usage needed to be considered in the context of the Guide as a whole.

120. In response to a concern as to how recommendation (42) would be invoked, in other words when would diminution of value be considered and what factors would it be assessed against, it was suggested that it would only be relevant in the event that the relief sought under recommendation (41) was not granted; the recommendation properly related to protection of secured creditors rather than diminution of value. It was observed that while recommendation (41) made it clear the creditor needed to seek the relief from the stay, it was not clear in (42) which party could make the request for court consideration.

121. It was proposed that the drafting of recommendation (42) could be clarified as follows: "The insolvency law should provide for the court to address an assertion by the secured creditor of the diminution of value of secured assets and consider appropriate protection." The second sentence and the first part of the third sentence would remain as drafted and the words "as a result of the imposition of automatic measures or the use of the secured assets by the estate" added after the word "erodes" in the third sentence. Paragraphs (a) to (c) would remain as drafted. That proposal received some support, although some reservations were made pending a closer examination of the proposed language. One concern expressed was that application of the stay, by itself, would not be sufficient grounds for considering diminution of value, as that might cover incidental loss of value for which the creditor should not be compensated. In response it was pointed out that the proposal did not mandate the provision of protection and some examples were discussed in which it was clear that diminution in value could in fact result from application of the stay without use of the asset.

122. A further proposal was that the recommendation should be drafted as a general principle providing that a balance had to be reached between insolvency objectives and secured creditor protection and where necessary appropriate safeguards should be provided.

123. It was suggested that in addition to recommendations (41) and (42) a provision allowing the secured creditor to ask the insolvency representative to release the secured asset in certain circumstances (particularly where the asset was of no value to the estate) without having to formally seek relief from the stay and providing the insolvency representative with the power to do so, might be useful.

124. After discussion, the following revised draft of recommendation (42) was proposed for future consideration by the Working Group.

> **(42) The insolvency law should provide that where the value of the secured assets does not exceed the amount of the secured claim or will be insufficient to meet the secured claim if the value of the secured asset erodes as a result of the imposition of automatic measures or the use of the secured assets by the estate, protection may be provided to the secured creditor. The insolvency law should [also] provide for the court to address an assertion by the secured creditor of the diminution of the value of secured assets and consider appropriate protections such as:**
>
> **(a) Cash payments by the estate;**
>
> **(b) Provision of additional security; or**

**(c) Such other means as the court determines will provide appropriate protection.**

[*Note: The commentary of the Guide would note, to the extent that it did not already, that where the value of the secured assets exceeded the amount of the secured claim and would be sufficient to meet the secured claim, protection may not be required.*]

## C. Use and disposition of assets (A/CN.9/WG.V/WP.63/Add.7)

### Recommendations

125. The substance of the purpose clause was generally found to be acceptable.

126. With respect to the chapeau of recommendation (43), it was observed that it might be inappropriate to refer to continuation of the business being "authorized" and a formulation along the lines of "Where the operation of the business is to continue ..." was suggested. That proposal was supported. It was also pointed out that while in liquidation the debtor would generally lose the ability to deal with assets, that was not true in reorganization, and the recommendation might need to be divided to address those differences more clearly. That suggestion received some support.

127. It was observed that an insolvency representative did not always have, under all legal systems, the right to sell assets, but could be a trustee or supervisor. In that case, the terms of (43)(a) could not apply. A related observation was that the recommendation only dealt with those cases where an insolvency representative was appointed and it may be inappropriate to provide those powers to a debtor in possession. In response, it was noted that some insolvency laws did allow the debtor in possession to retain those powers. A further view was that paragraph (a) could refer to the debtor under the supervision or control of an insolvency representative. That approach received some support. After discussion, it was agreed that different possibilities might need to be reflected.

128. Concern was expressed that the phrase "use, sell or lease" was too narrow and should be expanded to cover other means by which assets could be alienated from the estate, such as charge, encumber, or other disposal.

129. Support was expressed in favour of retaining the language in square brackets in (43)(b) that referred to the court and to other recommendations on use of secured and third-party-owned assets; and of amending the reference to "creditors" to the "creditor committee" and stating it as an alternative to approval by the court. An opposing view was that requiring approval by creditors or the creditor committee might be too cumbersome, and all that was required was the provision of notice to creditors and an opportunity for them to challenge the proposed action. A different view, which received some support, was that the focus should be upon the creditor committee and that approval of the court should not be required. In response to concern as to the meaning of "ordinary course of business" it was pointed out that that phrase was one commonly used in the insolvency context, but some further explanation could be included in the commentary.

130. After discussion, the following revised draft of recommendation (43) was proposed for future consideration by the Working Group.

**(43) Where the operation of the business of the debtor is to continue under a reorganization proceeding, the insolvency law should:**

**(a) Permit the debtor, under supervision of the insolvency representative, to use, sell, charge, lease or otherwise dispose of or encumber assets of the insolvency estate in the ordinary course of business;**

**(b) Permit the insolvency representative to use, sell, charge, lease or otherwise dispose of or encumber assets of the insolvency estate other than in the ordinary course of business, subject to approval by the court, unless the affected creditors consent, [and in accordance with recommendations in the Guide on the use of secured assets and third-party assets].**

**(43A) Where the operation of the business of the debtor is to continue under a liquidation proceeding, the insolvency law should permit the insolvency representative to use, sell, lease, charge or otherwise dispose of or encumber assets of the insolvency estate in the ordinary course of business, but should require approval by the court if assets are to be used, sold or leased out of the ordinary course of business.**

131. With respect to recommendations (44) and (45) some concern was expressed that those provisions repeated matters dealt with in recommendations (41) and (42) and could be replaced by a general recommendation to the effect that secured assets could be used in the proceedings subject to the protections provided in those earlier recommendations. In support of that proposal it was observed that if the secured assets were to be included in the estate as recommended in (27), there would be no need to include a further provision such as recommendation (44). Support was expressed in favour of including a general reference to recommendations (41) and (42) along the lines of "The property subject to security interests may be used but the rights and interests of the secured creditors [or owner] must be protected as set forth in recommendations (40) to (42)", with some alignment to be made with recommendation (43).

132. To the extent that recommendation (46) addressed assets in the possession of the debtor subject to contractual arrangements, it was suggested that it properly belonged in chapter III.D Treatment of contracts. It was also proposed that the language should be more limited, and a formulation along the lines that assets owned by a third party that were not part of the insolvency estate but were in the possession or control of the debtor and could lawfully be used by the debtor (or used by the debtor with the consent of the third party) could be used by the insolvency representative.

133. With respect to recommendation (47), it was suggested that it repeated the protections to be afforded to secured creditors and could perhaps be dealt with by way of cross reference to other recommendations. After discussion, some support was expressed in favour of deleting the substance of both recommendations (46) and (47) from chapter III.C and substituting a cross reference to chapters III.B or III.D, and ensuring that the issues were dealt with adequately in chapters III.B and III.D.

134. It was proposed that approval of creditors was not appropriate under recommendation (48) and that notice and an opportunity to object to the proposed

action was all that was required. It was observed that it might be inappropriate to provide such powers to a debtor in possession where no insolvency representative was appointed.

135. It was observed that the reference in recommendation (49) to "a reasonable indication" that the secured creditor could sell the asset more easily than the insolvency representative was too subjective a test and there was broad support for adopting a more objective approach. In reference to the use of the phrase, "of no value", it was noted those words were used elsewhere in the Guide and it was suggested that they be replaced with, "where the value of the secured claim exceeds the value of the asset". It was also suggested that a cross reference be added to the discussion on claims, specifically to the point that a limitation should be placed on the claim of a secured creditor where an asset was released to it. Of the bracketed words in the second sentence, "may" was agreed to be more appropriate.

136. Following discussion of recommendation (50), the Working Group agreed (i) that of the bracketed words in the last sentence of (50), "approval by the court" should be retained; (ii) that the approval by creditors should be amended to refer to the creditors committee or other creditor body and stated as an alternative; (iii) that the provision should focus on sales outside the ordinary course of business; and, (iv) that an addition should be made to the commentary regarding notification and publicity requirements for a public auction. There was some support for allowing for the notification, rather than the approval, of creditors, provided there be an opportunity for creditors to challenge a sale in the court if they disapproved. Some support was also given to the notion that (50) should focus on methods of sale only.

137. Drafting suggestions included inserting the phrase, "outside the ordinary course of business", after the words, "notice of any sale", and again after the words, "private sales" and removing the two bracketed phrases in the first sentence. An alternative suggestion was that the phrase "outside the ordinary course of business" be removed from square brackets and placed after the words, "method of sale", and also that the brackets be removed from, "whether in liquidation or reorganization".

138. Support was expressed in favour of providing that in circumstances where an urgent sale of assets was required, for example, where the assets might be subject to rapid deterioration of value, notification and/or approval of creditors or the court might not be necessary, or that approval might be given after the sale. A suggested addition to recommendation (50) was that proposed sales to insiders be carefully scrutinized before being allowed to proceed. It was also suggested that the recommendations be reordered so (50) came before or followed (48), (49) and (51).

139. There was general agreement that footnote 5 to recommendation (51) should be deleted, as it unnecessarily restricted the grounds on which a secured creditor could object to a sale, and that a new clause should be added to (51) to the effect that if the proceeds of a sale exceeded the value of a secured claim, no protections for the secured creditor were required. With regard to (51)(b), different views were expressed regarding the party to whom the creditor should object, with some support being given to the suggestion to amend the sentence to, "object to [the court or the insolvency representative regarding]".

140. It was suggested that some detail was needed regarding the procedure for valuing the asset to be sold and that that could be included in the commentary. A proposal was made that a clause be added to recommendation (51) providing that,

even where the court approved a sale, if the offer for the asset was inadequate, the secured creditor retained the right to offset the bid to protect its interest.

## D. Treatment of contracts (A/CN.9/WG.V/WP.63/Add.8)

### Recommendations

141. It was agreed that the phrase, "and by whom", in square brackets in clause (b) of the purpose clause be retained and the brackets removed.

142. The substance of recommendation (52) was found to be acceptable.

143. The Working Group agreed to the following changes to recommendation (53): that in the opening words "should" was preferable to "may"; that the phrase "a right to terminate" be replaced with, "for the automatic termination of", to remove the impression that (53) might also refer to election to terminate; and, that the substance of (53)(c) and (53)(d) be moved to the commentary. It was also agreed that the commentary should note that (53) applied only to those situations where contracts could be overridden and that its provisions were non-exclusive. It was suggested that the commentary include an explanation that the court could look at similar types of contractual clauses that would have the effect of terminating on such events.

144. It was noted that recommendation (53) as drafted applied all types of contracts but that some, such as contracts to lend money, should be excluded. Drafting suggestions included that: the phrase, "upon the commencement of insolvency proceedings" be added to the start of (53); the square brackets around the phrase, "as against the insolvency representative" be removed and the words "and the debtor" added; and the words, "or identify as an event of default", be deleted.

145. The Working Group agreed that the substance of recommendation (54) was acceptable, if the question of the effect on, and rights of the other contracting party were dealt with in recommendations (53) and (56). That included notification of the insolvency representative's decision to the contracting party and the ability of that party to challenge that decision. It was also noted that there were differing views regarding the necessity of approval of the court in such circumstances, which might be discussed in the commentary.

146. With respect to the exception included in parentheses in recommendation (55), it was suggested that it should be deleted on the basis that once a contract had been continued, all terms should be enforceable. On the basis that the insolvency representative should not be responsible for a breach of an automatic termination clause, it was proposed that the exception should be moved to after "and" and before the word "damages" to link it specifically to damages rather than enforceability. Some concerns were expressed as to the potential liability of the insolvency representative on the basis of the words in the last line "breach of the contract by the insolvency representative" and after discussion it was agreed that the reference to the insolvency representative should be deleted, and that the exception should also be deleted. With respect to the use of the word "continues" it was suggested that a different term should be used, such as "adopted" or "assumed", to make it clear that damages would be relevant only for those contracts that the insolvency representative affirmatively decided to continue. A concern was raised that the recommendations did not address contracts of which the insolvency

representative was unaware and how they would be treated. In particular, it was suggested that failure by the insolvency representative to address such contracts should not amount to a decision to continue.

147. Proposals with respect to the drafting of recommendation (56) were that the phrase "time of commencement" should be amended to "before commencement"; paragraph (a) should refer to the "insolvency estate's" ability; the references to "continuation" should refer to "continuation of performance", both in (56) and throughout the Guide; the use of the words "decide to" should be used consistently throughout the Guide, or a different formulation used to indicate contracts in respect of which the insolvency representative had made an affirmative decision to continue; and the words "will have" be retained in (56)(b).

148. It was agreed that because the formulation "is capable of being cured" in recommendation (56)(a) was too broad and susceptible of abuse it should be deleted. It was noted however, that an obligation to cure breach should not be absolute and the word "substantially" should be added to (56)(a) after "returned". Use of the phrase "appropriate assurances" was questioned and in response it was suggested that what was required was a guarantee of performance from the insolvency representative. It was agreed that contracts, however described, for the provision of essential services, such as water and electricity may need to be addressed, but that the formulation in square brackets in (56)(b) was not appropriate. The debtor must be assured access to those services, especially where the application for commencement was an involuntary application, and on the basis that it could perform its post-commencement obligations, the service should continue to be provided. It was suggested that some examples of the types of contracts under consideration could be added to the commentary.

149. With respect to rejection, it was observed that some jurisdictions did not provide a power to reject contracts as performance of a contract simply ceased unless the contract was adopted by the insolvency representative. On that basis, it was suggested that that option be discussed in the commentary, and the word "should" in recommendation (57) be changed to "may". After discussion, the substance of the recommendation was found to be acceptable with the suggested amendment.

150. The substance of recommendations (58) and (59) was found to be acceptable as drafted. The substance of recommendation (60) was found to be acceptable with the removal of the square brackets and retention of both texts.

151. In response to a concern that the time of rejection in recommendation (61) should not be effective retroactively, it was suggested that the requirement for the insolvency law to set the time should overcome that problem. Any issues with respect to the desirability of retroactive effectiveness should be addressed in the Guide.

152. With respect to recommendation (62), changes suggested were that the word "affirmatively" be added before "decide to" and the parentheses removed from the following text; that the word "may" in the opening phrase be changed to "should"; that "may" in the second sentence be changed to "should"; and the word "limit" be replaced by "period". With respect to the text in parentheses, it was proposed that the insolvency law should set specific time periods in those cases where a decision was required to be taken. With respect to the second sentence of

recommendation (62), it was suggested that the consequences of failure to act should be discussed in the commentary. One example proposed was that the contract would be unenforceable and it was suggested that any provisions added with respect to consequences should address the potential difference between liquidation and reorganization. It was recalled that paragraph 140 of the commentary perhaps adequately addressed that issue, an approach which received support. A further suggestion was that a reference to provision of a list of contracts could be added to recommendation (92)(d).

153. The Working Group agreed that the words in square brackets at the beginning of recommendation (63) be retained and the brackets removed, and that the drafting of recommendation (63) be improved to read "to take a prompt decision". A suggestion that was supported was that prejudice should never be a condition for a request to make a decision and the words following "with respect to a contract" should be deleted. To address what could occur if the insolvency representative failed to take a decision, it was suggested that the text be adjusted to read, "the insolvency law should permit a counterparty to request of the insolvency representative, or the court in the event that the insolvency representative failed to act, that the insolvency representative take a prompt decision". That would enable the counterparty to ask the court to order the insolvency representative to act where it failed to do so.

154. After discussion it was agreed that recommendation (64) was not needed and could be deleted together with the opening words of (65) up to "the insolvency law" and that recommendation (65) should retain the words "might provide". It was also agreed that paragraph (c) of recommendation (66) properly belonged to recommendation (65) as a pre-condition for assignment. In recommendation (66)(a) it was suggested that the phrase "post-commencement" be added before "obligations" for greater clarity. It was agreed that the words in square brackets in recommendation (66)(c) be retained and the phrase amended to read "is necessary or of benefit to the estate", which would cover both reorganization and liquidation. The remaining words could then be deleted. A proposal for an additional sentence to be added to recommendation (66) along the lines of "The insolvency law may further provide that if the contract is assigned, the assignee is substituted for the debtor as the contracting party from and after the date of the assignment" received some support. In terms of the language on unreasonable harm or disadvantage, it was decided after discussion that both options should be retained as possible alternatives. In response to a question concerning the need to cure defaults before assignment of a contract, it was agreed that that issue should be addressed in the commentary.

155. Some concerns were expressed as to the intention of recommendation (67) and the contracts that should be included. There was general agreement that labour contracts should be addressed in view of the applicable international regimes. After discussion, the Working Group agreed on the need for a general provision referring to the special treatment of certain types of contracts, with the addition of some examples, such as labour contracts.

156. The Working Group agreed to delete the reference in recommendation (68) to "the ordinary course of business". It was suggested that a cross reference could be added to address post-commencement contracts that might be avoidable or unauthorized.

## E. Avoidance proceedings (A/CN.9/WG.V/WP.63/Add.9)

### Recommendations

157. With respect to the purpose clause, the Working Group agreed to the use of "reconstitute" and "equitable" in paragraph (a) and in paragraph (b) to retain all of the words in square brackets and to change "or" to "and".

158. With respect to recommendation (69), the Working Group agreed that the reference to "net worth" should be changed to "value of the insolvency estate" and that the term "equitable" rather than "fair" should be retained. The words in square brackets "[or authorized transactions occurring after [application for] commencement]" should be aligned with the wording agreed in the purpose clause.

159. The Working Group discussed a number of aspects of the criteria under recommendation (70) for avoidance of transactions and agreed, in respect of paragraph (a), that the words "by, for example, the transfer of assets to any third party" should be deleted and the underlined text retained. With respect to the issue of the knowledge of the third party, the prevailing view was in favour of amending the requirement to "the third party knew or should have known" of the debtor's intent. Defences available to the third party should be further addressed in the context of recommendations (79) and (80) on evidentiary issues. To address an alternative suggestion that the types of transactions referred to in paragraph (a) might be avoidable where the debtor was insolvent, in which case the knowledge required of the third party would relate to the fact of insolvency, further discussion could be included in the guide. It was also agreed that in paragraphs (b) and (c), the word "insolvent" should be retained and the words "had ceased making payments" should be deleted, where the term "insolvent" should be defined by reference to the Working Group's previous discussion in the context of commencement criteria and further explained both in the commentary and the glossary.

160. The Working Group agreed that recommendation (71) addressed two ideas that should be retained in the Guide: (i) where a security interest was valid or effective and enforceable under law other than the insolvency law, the insolvency law should recognize that validity or effectiveness and enforceability; and (ii) notwithstanding that a security interest might be valid or effective and enforceable under other law, it may still be subject to the avoidance provisions of the insolvency law. The Working Group did not resolve the placement of the first principle in the Guide. With regard to the second principle, support was expressed in favour of incorporating the substance of footnote 3 into recommendation (69) to better explain what was intended.

161. Several changes were proposed with respect to recommendation (72). It was proposed that paragraph (a) was not necessary and should be deleted. In response to a suggestion that "may" be substituted with "should" in paragraph (b), the view was expressed that since no particular times were recommended, it was difficult to see how or why the period should be longer for related persons if the suspect period applicable in the case where no related person was involved was already a long period of time, and the word "may" should be retained. It was proposed that paragraph (c) be divided into two paragraphs, with one addressing the issue of presumptions and the other shifts in the burden of proof required to facilitate avoidance of transactions detrimental to the insolvency estate. It was noted that

since the term "related persons" could cover a variety of persons, both natural and legal, it should be defined in the glossary.

162. The substance of recommendations (73) and (74) was agreed to be acceptable.

163. With respect to recommendation (75), the Working Group agreed that the suspect period should be "calculated retrospectively from" either the date of application for commencement or the date of commencement of proceedings, with both options to be retained in the recommendation and further explained in the commentary.

164. Different views were expressed with respect to the desirability of creditors commencing avoidance actions and whether that ability should be in addition or substitution to that of the insolvency representative, and whether approval of the court would be required (recommendation (76)). One view was that creditors could only commence avoidance actions in cases where the insolvency representative decided not to or where the insolvency representative was in agreement that the action should be taken by creditors. The need to respect the central role and responsibilities of the insolvency representative in administering the estate was cited in support of that view. In any event, it was observed that the insolvency law should emphasize that the purpose of avoidance actions was to return value or assets to the estate, not to benefit some other party. As a different approach, it was noted that some insolvency laws provided that the agreement of creditors or the majority of creditors was required in order for the insolvency representative to commence an avoidance action. Creditors who did not agree to the insolvency representative taking such action could themselves take that action at their own risk.

165. Another view was that where creditors were permitted to commence an avoidance action, that ability should be subject to approval by the court, although it was also noted that in some countries it might be problematic to require court approval to commence such an action. Where an issue of creditor abuse might arise if creditors were able freely to commence avoidance actions, sanctions could be imposed against the creditor or the creditor could be required to pay the costs of the action. A further view was that court approval should not be required as a matter of course, but rather that the power of creditors to commence such actions should be dependent upon agreement in the first instance by the insolvency representative. If the insolvency representative did not agree, then creditors could seek court approval and the insolvency representative would have the right to be heard as to why the avoidance action should not be pursued. It was noted that that approach was desirable also to prevent possible deal-making between the various parties. After discussion, the prevailing view was that creditors could have the power to pursue avoidance actions, but should first be required to consult with the insolvency representative and where the insolvency representative did not agree, could seek approval of the court (which might give leave to commence the avoidance action or hear the case on the merits).

*Notes*

[1] Ibid., *Fifty-fifth Session, Supplement No. 17* (A/55/17), paras. 400-409.
[2] Ibid., *Fifty-sixth Session, Supplement No. 17* (A/56/17), paras. 296-308.
[3] Ibid., *Fifty-seventh Session, Supplement No. 17* (A/57/17), para. 194.